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East Africa: Accumulating Economic Woes

An Intelligence Assessment

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ALA 82-10084
June 1982

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*Information available as of 21 May 1982
has been used in the preparation of this report.*

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East Africa: Accumulating Economic Woes

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Key Judgments

East Africa's strategic importance and proximity to major oil transport routes has increased superpower interest in the area. Soviet influence is particularly strong because of Moscow's close ties to the Marxist regime in Addis Ababa and the Soviet and Cuban role in making Ethiopia black Africa's foremost military force. To counter the threats to the continued flow of oil, Washington has signed agreements with the Kenyan and Somali Governments that permit US access to their military facilities.

The increase in East Africa's political and military importance coincides with deteriorating economic conditions in the area. Before the mid-1970s, East African countries—from Ethiopia south to Tanzania—generally met their basic food requirements, their urban populations were small and undemanding of public services, and financial stresses were manageable. Ironically, their large subsistence sectors for a time cushioned most of the area's 85 million people from the severe internal and external shocks that struck during the first half of the 1970s. Some countries, notably Ethiopia and Tanzania, even made significant improvements in rural living standards.

Since the mid-1970s, however, East African governments have come under unprecedented stress over the handling of their economies. The entire region now desperately needs money, basic foodstuffs, and producer supplies. Discontent and unrest are likely to increase the potential for political instability and encourage Soviet, Cuban, and Libyan meddling. The need for money also clearly played a key role in the willingness of both Kenya and Somalia to accede to Washington's request to use their military facilities.

Reforms dictated by the International Monetary Fund, when implemented, have had limited impact because of the size of the task and because of backsliding in the face of political risks. Area leaders are also inclined to dissipate limited resources in uneconomic but politically important efforts to appease tribal, regional, and other frictions. Key economic posts go to inexperienced political cronies, and corruption is an increasingly disruptive fact of life.

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In the Horn of Africa, the armed insurrection by separatists in Eritrea and Tigre, the hostilities in the Ogaden, and drought have compounded the chaos that ensued from the sweeping socialist restructuring of the Ethiopian and Somali economies during the 1970s. A tendency to rely on immediate gains from income redistribution more than on laying the foundation for sustained economic growth has only hastened the day of reckoning for Mogadishu and Addis Ababa.

The area south of the Horn also faces grave problems:

- Kenya, once one of Africa's star economic performers, has had a steady decline in its once thriving agricultural sector, as unchecked government spending through inefficient public corporations restricted the country's potential. Population growth of 4 percent annually—among the world's highest—threatens to overwhelm the country's fragile rural-urban balance.

- Uganda is recovering from the excesses of the Idi Amin regime, but still faces great difficulties as President Milton Obote struggles to control internal security.

- Tanzania, disillusioned with President Julius Nyerere's socialist experiment, is at an impasse with the IMF over corrective strategies; even such liberal past donors as the Scandinavian countries are growing impatient with Nyerere's refusal to undertake necessary reforms.

Over the next few years, the outlook for economic recovery throughout East Africa—and therefore for the area's political stability—is grim. The mounting burden of enormous arms debts will be an additional throttle on several of the region's economies. The longer these countries forgo badly needed IMF financial guidance and money, the harder it will be to accommodate Western financial backers.

Able until recently to blame outside factors for their depressed economies, East African leaders are increasingly the target of popular discontent. Dismantling inefficient parastatal enterprises risks offending powerful vested interests. Even a sustained commitment to reorganizing key institutions would require time. Meanwhile, economic well-being in East Africa will depend largely on the thin hope of good weather and strong world demand for key agricultural exports.

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Against this background, the political leadership will increasingly try to make the IMF a scapegoat while expecting the United States and other principal Western donors to increase their aid. Most East African leaders believe that Washington's emphasis on private investment masks an unwillingness to come to their support.

Ethiopia probably is willing to make only token economic or political concessions to attract Western aid and investment. As long as secessionist threats remain, Chairman Mengistu believes Soviet military support is more important than Western financial capital. Nevertheless, Soviet-Ethiopian relations could come under heavy stress as Ethiopia's military debt repayments mount in the mid-1980s.[1]

The moderate Governments of Somalia and Kenya will expect Washington to shoulder a larger aid burden, including stretching loan repayments in return for continued US access to their military facilities. These governments already are sensitive to claims by opponents that access agreements implicate them in superpower politics. They could decide to modify the agreements substantially or, over the longer term, cancel or refuse to renew them if US aid does not meet their expectations.

The Governments of Uganda and Tanzania are likely to make only slow progress dealing with their economic problems, as both are debilitated by serious problems outside the realm of economic management. In Uganda, continued lack of public security precludes effective long-range planning, investor confidence, and normal commercial activity and agricultural production. In Tanzania, Nyerere's personal and political commitment to his unique form of socialism prevents him from coming to terms with the IMF and securing critical foreign assistance.

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[1] This paper examines the economic problems and prospects of Kenya, Uganda, Tanzania, and Somalia.

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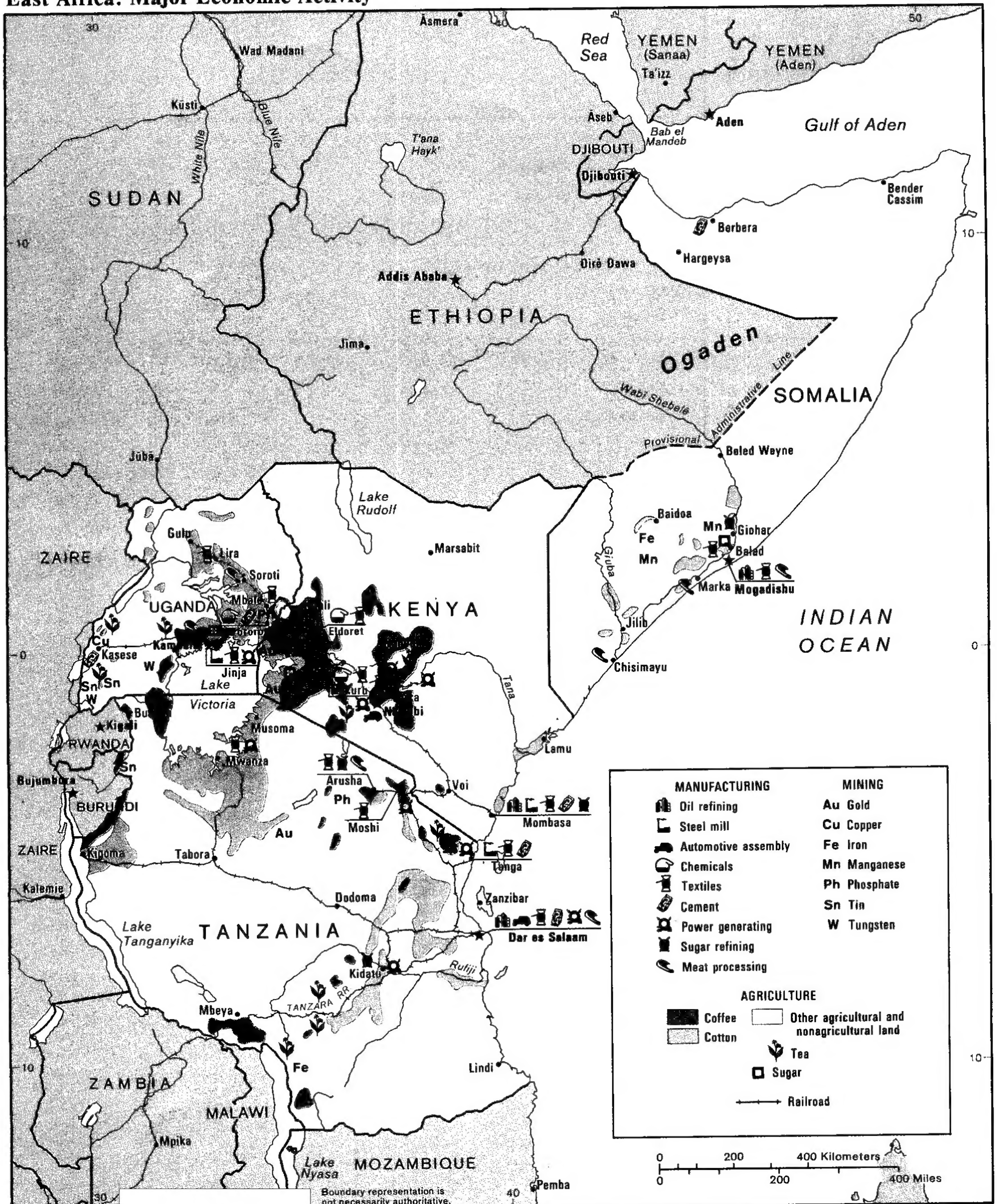
East Africa: Major Economic Activity **Figure 1**



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East Africa: Accumulating Economic Woes

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Kenya: Deepening Economic Problems [1]

Kenya's deteriorating economy is President Moi's most difficult challenge since he assumed office in 1978. Once thriving agriculture has been hit by bad weather, inappropriate government policies, and weak world demand for coffee and other export crops. These forces also have affected Nairobi's international payments position and halted an ambitious economic development program. Inflation is at a record rate, and corruption is increasing.

Prospects for improvement are uncertain. Over the next few years, Nairobi must restore agricultural productivity to provide the foreign exchange needed to resume industrialization. The longer term outlook depends on how the government copes with a population growth rate of 4 percent—among the highest in the world—that threatens to overwhelm the country's already fragile urban-rural balance. In the meantime, Moi is counting on US aid and investment to bail him out in return for his agreement to allow US access to Kenyan military facilities.

A Marked Decline. Kenya's current economic difficulties are in marked contrast to 15 years of steady economic growth under the firm hand of former President Jomo Kenyatta. From 1963 to 1978, economic expansion averaged 6.5 percent a year, a record in black Africa exceeded only by that of Ivory Coast. An essential element in this success was Kenyatta's pragmatism and stature as a leader of the independence struggle. These qualities enabled him to satisfy African demands for a share of economic benefits without driving away expatriate farmers and merchants, whose expertise had developed Kenya's colonial economy and was needed to keep it functioning. He controlled ethnic and racial animosities, built a national consciousness, and intensified economic development. Moreover, Kenyatta's determination to hold back on expanding African participation in the economy attracted a large number of international private investors who did much to develop a flourishing manufacturing base and a tourist industry.

Kenyatta's formula had its flaws, however, and these were already affecting the country's economic health by the time of his death in August 1978. Heading the list was the government's refusal to take measures to reduce Kenya's staggering population growth rate, which was putting increasing pressure on land availability and basic urban amenities. Per capita food production was slipping as a result of low government-set producer prices and Nairobi's insistence that all agricultural goods be marketed through inefficient public corporations. The 1973-74 leap in world oil prices and subsequent surge in import costs exposed the vulnerability of hinging industrialization on imported raw materials, machinery, and spare parts. The business community received another jolt in 1977 when the dissolution of the East African Community[2] and the overthrow of Idi Amin cut off markets in neighboring Tanzania and Uganda. Finally, Kenyatta had permitted much of the country's economic wealth to be concentrated in the hands of his family, and of the Kikuyu, Kenya's largest tribe.

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Squandering Economic Potential. Moi—who was uncomfortable with economic matters and preferred to leave them to his advisers—did little during his first year in office (1978-79) to tackle Kenya's emerging economic problems. His primary concern was consolidating his political position and reducing the preponderant influence of the Kikuyu tribe. Government spending continued unchecked and payoffs became a prerequisite for conducting even simple bureaucratic tasks. Although substantial amounts of money continued to enter the country, much was diverted through corruption.

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[1] This paper examines the economic problems and prospects of Kenya, Uganda, Tanzania, and Somalia.

[2] The East African Community was a common services organization and customs union consisting of Kenya, Tanzania, and Uganda. It disbanded largely because of discontent over Kenya's economic dominance.

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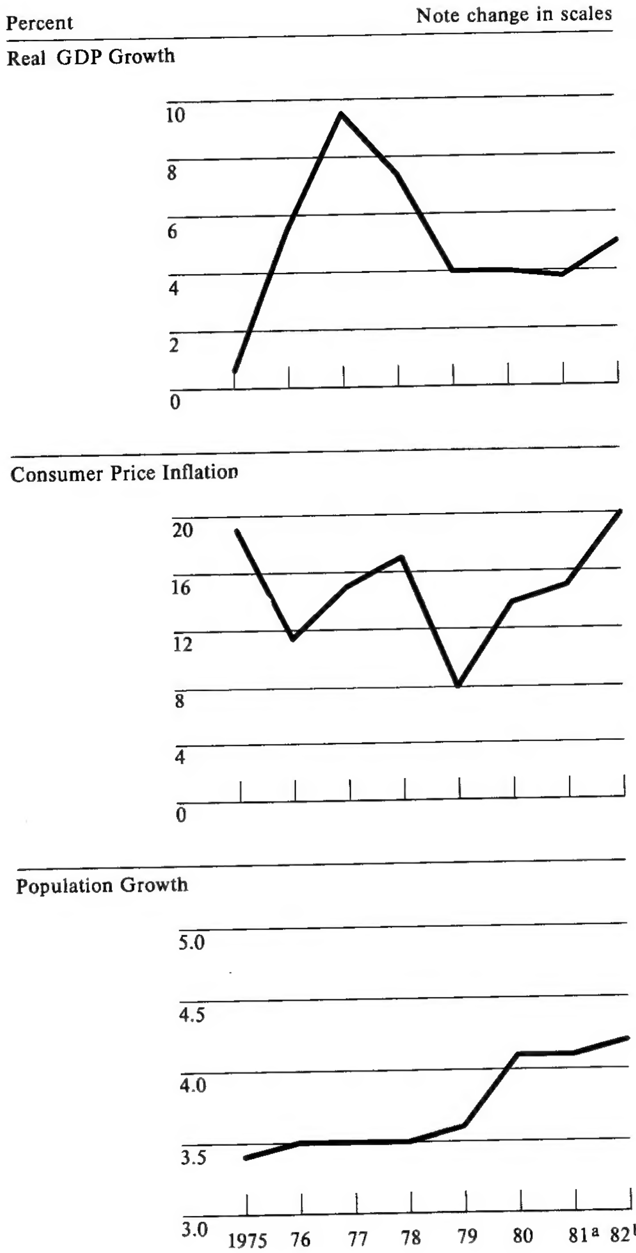
Figure 2

Kenya: Economic Indicators



[a] Estimated.
[b] Projected.

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Moi's refusal to devise an economic program coincided with the maximum impact on Kenya of global economic recession. The country's international trade balance was hit by a combination of reduced export receipts—the result of depressed coffee prices and the decline in tourism—and record import levels associated with the newly launched development program. Nairobi tried to cope with these problems by imposing import controls, but these did little to offset a bulging current account deficit even though they cut economic growth nearly in half.

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The next hurdle was the severe drought in late 1979 and early 1980. Production of corn, the main dietary staple, fell to the lowest level in nearly 10 years. Shortages were especially serious in Nairobi because farmers refused to supply the government distribution network that was responsible for the cities' needs. Widespread reports that rural officials were hoarding stocks in preparation for resale at exorbitant prices aggravated the situation. Moi extricated himself from a potentially explosive problem only by spending almost $200 million in limited foreign exchange for food imports.

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The food crisis forced the regime to reevaluate its rapidly deteriorating financial position. The government's refusal to follow the sharp fall in coffee prices with cutbacks in development spending was pushing Kenya's current account and budgetary deficits toward dangerous highs. By 1980 the country's annual overseas financing needs were approaching $1 billion, nearly 20 percent of the country's gross domestic product. At the same time, excessive public spending on defense, education, health, and consumer subsidies ultimately contributed to a record shortfall of $570 million in the fiscal year that ended in June 1981.

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During 1980/81 the government covered its various deficits with a combination of heavy borrowings on both international and local markets and some belated attempts at financial discipline. In return for a two-year, $310 million loan from the International Monetary Fund, Kenya agreed to impose budgetary controls, particularly on the parastatal corporations. The parastatals, however, were the preserve of old Kenyatta cronies and other powerful political interests whose support Moi needed, and he backed off from

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Table 1

Kenya: Trade and Financial Indicators

Million US $ (Except As Noted)

	1975	1976	1977	1978	1979	1980	1981 [a]
Trade balance	−461	−445	−89	−685	−555	−1,087	−1,129
Exports, f.o.b.	648	825	1,195	1,025	1,104	1,243	1,114
Imports, c.i.f.	1,109	1,270	1,284	1,710	1,659	2,330	2,243
Net services and transfers	−68	−100	−29	−38	−6	56	420
Current account	**−529**	**−545**	**−118**	**−723**	**−561**	**−1,031**	**−709**
Foreign exchange reserves	169	272	504	338	520	466	216
External debt	570	700	920	1,085	1,435	1,745	2,095
Debt service ratio (percent)	3.6	4.4	3.7	7.0	6.6	8.9	14.0

[a] Estimated.

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infringing on their activities. Not surprisingly, Nairobi failed to meet the Fund guidelines on expenditures, and the loan agreement and disbursements were terminated in December 1980.

Although Nairobi again in 1981 failed to limit spending effectively, it was somewhat more successful in limiting imports. The processing of import licenses was deliberately delayed, foreign exchange allocations were rationed, and the currency was devalued by 25 percent. Import control implementation was, however, impeded by disputes between various government ministries and the central bank over authority for controlling the licenses. In the meantime, applications for industrial goods were often held back, while those for consumer items were quickly approved, usually with the aid of a kickback.

In response to heavy public pressure, import restrictions were lifted after only six months, but they did keep 1981 import spending below that of the previous year's record. They also resulted in a sharp slowdown in business activity, as the lack of timely deliveries of spare parts forced many firms to close their doors or substantially reduce production. The industrial recession in turn paved the way for another year of unacceptably high inflation and slow economic growth, as well as a worrisome unemployment rate of nearly 20 percent.

1982—Another Inauspicious Year. The current year will provide another stiff test of Moi's ability to control the economy and show Kenyans that he can be forceful and decisive when necessary. Moi's central dilemma is how to restrain budgetary spending. As part of a second standby arrangement signed late last year with the IMF, Moi agreed to cut this year's budgetary deficit by nearly 40 percent. According to Nairobi officials he hopes to do this primarily by limiting government salaries and spending on defense, education, and foreign travel. He also announced the suspension of the *harambee* system, which made government money available to Kenyan politicians for local projects and had become an important source of corruption. Finally, Nairobi consented to bring the entire budgetary process under closer scrutiny by requiring ministries to submit monthly reports of their revenues and expenditures. As a warning to officials to take their financial responsibilities seriously, Moi has ordered the central bank not to cash payroll and other checks of various parastatals when they have exceeded their budgets.

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On the international front, the Embassy feels that Moi's main concern is financing what Nairobi hopes will be no more than a $600 million current account deficit this year. Even this requires a major push in

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exports and holding import spending to last year's total, goals that appear to be out of reach. Last year's devaluation not only boosted import prices by nearly 20 percent, but also prompted a heavy demand for overseas goods in anticipation of still another devaluation. At the same time, international coffee prices are still in the doldrums, hampering Nairobi's ability to achieve what it hopes will be a record year for overseas sales. Export receipts are also down because of the government's decision to divert an increasing share of its refined petroleum products to local consumption instead of reexporting them for foreign sales.[3]

The result has been a sharp drawdown in foreign exchange reserves, which reportedly are now insufficient to cover a month's worth of imports. Kenya has responded with another slowdown in processing import licenses and by not meeting deadlines for payment of outstanding bills. These measures will not help Kenya's credit rating when it goes abroad in search of additional commercial loans. Indeed, they may already have held up completion of a large World Bank loan and additional funds from the IMF.

The rest of this year will not be easy for Moi as he tries to lay the groundwork for financial stability and economic recovery. He has made it clear to Embassy officials and Western donors that foreign assistance—especially from the United States—is vital. Recent complaints about what Moi believes is Washington's stinginess underscore his concern about obtaining such aid. Although Moi has met some IMF conditions on public spending, he is unlikely, in our view, to be able to continue these restrictive measures without creating political problems. This may mean an interruption in access to vital IMF funding. Any related interruption in the flow of imports will have a direct impact on Kenya's industrial performance and on Nairobi's ability to satisfy relatively sophisticated consumers.

Despite the economic pinch, recent open-source material indicates that most Kenyans realize their living standards are still considerably better than those of their neighbors. Such reasoning, however, will probably start to wear thin without a break in the circle of high unemployment and record inflation. Moreover, continued economic hard times are certain to add to the difficulties Moi faces in trying to reduce corruption. While the President works on budget cuts, his opponents will focus on kickbacks as a major source of excessive government spending. At the same time, civil servants—faced with shrinking real incomes—will, in the Embassy's view, be increasingly tempted to engage in illegal financial deals to supplement their incomes. 25X1

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The Next Decade. Even if Moi survives the year with only some slowdown in the economy, he—and any successor—faces a number of problems over the next decade that will severely test Kenya's political and economic systems. The country will encounter more serious social and economic pressures—rapid population growth, increasing rates of urbanization, declining food production, high levels of unemployment, and rising import bills. As competition for finite or diminishing natural resources increases, more intense rivalry among Kenya's tribal groups is likely. Moi's ability—or failure—to balance these various demands will determine his political future. 25X1

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Probably the most critical need is to slow the population explosion and the impact of continuous internal migration. At its current rate, Kenya's population will double during the remainder of this century. The impact of this increase will be felt most heavily in the countryside. Kenya needs to double food production within the next 20 years just to regain self-sufficiency, but expansion at this rate will be difficult as increasing amounts of marginal land are brought into production. With the poor outlook for agriculture, Kenya will have to base future economic development on manufacturing. For this policy to be effective, however, the government must improve industry's efficiency and reduce its dependence on imports for raw materials and spare parts. 25X1

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The alternative is to increase reliance on foreign financial assistance to maintain economic stability. According to Embassy sources Kenya's current leadership expects Washington to shoulder a sizable share of this burden in return for continued US access to Kenyan military facilities. 25X1

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[3] Kenya's refinery at Mombasa, using imported crude oil, provides around 60,000 barrels per day of refined products for export to regional consumers, including several Indian Ocean islands.

Tanzania: Nyerere's Stabilization Crisis

Tanzania's economy is suffering from accumulating external and internal problems that seriously threaten Julius Nyerere, the President since independence in 1961. In the last 10 years, rising oil prices, fluctuating export earnings, and prolonged drought have wreaked financial havoc on an economy already beset by pervasive mismanagement and corruption. More recently, Nyerere's insistence on inefficient state control of the economy and a stalemate with the International Monetary Fund over stabilization strategies have led to deepening shortages and inflation, opening Nyerere to unprecedented domestic criticism.

Import constraints and continuing mismanagement probably will lead to further declines in already low incomes this year. Real growth in gross domestic product is likely to be substantially less than population gains, and short-term credit arrears will probably increase unless there is an IMF agreement. Moreover, the combination of high levels of government deficit spending and the shortages of consumer goods that accrue from import limitations will add to an inflation that is now running at 35 percent.

Tanzania's agrarian-based economy has little hope of a substantial recovery anytime soon. A break in the impasse with the IMF probably would—at best—only avert further income declines over the next three to five years. Even a new government more favorably disposed toward capitalist-oriented policies would require continuing large infusions of foreign aid to correct longstanding deficiencies in investment and maintenance of transportation facilities. Meanwhile, Tanzania's heavy dependence on a few export commodities to earn needed foreign exchange leaves it vulnerable to world economic conditions.

The Roots of Nyerere's Problems. In 1967, President Nyerere launched a development program (*ujamaa*) designed to mesh socialism and traditional African communalism. This program entailed wholesale nationalization in most economic sectors and a settlements plan that would bring Tanzania's rural population—95 percent of the country's total—together in loose communes, to promote food self-sufficiency and to reduce dependence on foreign aid.

Nyerere's Troubled Socialism

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1967	*Arusha Declaration spells out Tanzanian Government's long-term economic and social objectives, including public ownership of production, broad-based rural development, national and local development efforts aimed at self-reliance, universal education, and sustained economic growth. Overall program, entitled* ujamaa, *aims to reduce gap between rich and poor and to inhibit formation of social classes.*
1974-76	*Government accelerates rural development by creating cooperative villages for communal agricultural production.*
1981	Ujamaa *"temporarily" shelved because of disruption of farm production and government's inability to meet minimal needs of estimated 30,000 people in communal villages.* 25X1
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	Program for National Economic Survival unveiled to increase production in agriculture and industry. Key objective is generation of additional income from higher agricultural production. Program long on goals but short on implementation plans. 25X1
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1982	*Prime Minister's office introduces plan to strengthen rural cooperative societies in order to streamline distribution and marketing. Program, which reinforces* ujamaa, *adds another bureaucratic layer to already cumbersome system. Disillusionment among rural population prompts some migration back to traditional villages.* 25X1

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The resultant disruptions soon exacted a heavy toll. The comprehensive economic restructuring required management and planning skills far beyond Tanzania's capabilities. Moreover, the government's commitment to raise living standards increasingly diverted scarce resources from critical productive sectors. The creation of some 400 powerful parastatals in commerce and light manufacturing merely fed opportunities for corruption, and these companies began to dominate the entire Tanzanian economy. 25X1

Soaring world oil prices after 1973 deepened Tanzania's economic troubles. Its net oil import bill jumped from $34 million in 1973 to almost $100 million by 1977. Meanwhile, periodic droughts prevented domestic producers from capitalizing on scattered price peaks for the country's principal exports—coffee, tea, and cotton. After mid-decade, rising coffee prices failed to offset declining prices for Tanzania's other major export earners and the stagnation of manufactures exports such as textiles. Real GDP growth averaged under 4 percent annually during 1974-77 and, with population growing more than 3 percent, income gains were minimal. Only the imposition of import controls and generous Western aid—at over $30 per capita each year, much higher than most other LDCs—kept incomes from declining. 25X1

Dar es Salaam's decision to loosen import controls and another round of world oil price increases drove trade and current deficits to new highs in the late 1970s. The seriousness of the crisis sent the Tanzanian Government to the IMF for balance-of-payments assistance. Tanzania had no trouble getting compensatory financing of $43 million in early 1979, but negotiations for a $250 million standby agreement broke down in late 1979 over IMF insistence on increases in domestic interest rates, removal of price controls, and a substantial currency devaluation. 25X1

Like Kenya, Tanzania also faced payments drains associated with the breakup of the East African Community and the three-year-long war in neighboring Uganda. Following the dissolution of the Community in 1977, Dar es Salaam had to assume much greater staffing and financing responsibility for the rail, port, and air services that had previously come under Community auspices. Tanzania's inability to take on these tasks successfully meant that rehabilitation and routine maintenance suffered, particularly in Dar es Salaam harbor, Tanzania's largest deepwater port. The Tanzanian war with Uganda—which began in 1978—further complicated problems accruing from the break with its neighbors. The offensive against Uganda spurred an immediate 50-percent rise in public spending that further diverted resources from productive sectors. 25X1

Table 2

Million US $ (Except As Noted)

Tanzania: Selected Economic and Financial Indicators

	1978	1979	1980	1981
Trade balance	−613	−538	−736	−945
Exports, f.o.b.	432	527	524	511
Imports, c.i.f.	1,045	1,065	1,260	1,456
Net services and transfers	179	207	147	194
Current account balance	**−434**	**−331**	**−589**	**−751**
Foreign exchange reserves (yearend)	92	64	20	17
Debt service ratio (percent)	9.4	8.6	15.4	16.9
Inflation rate (percent)	11.6	13.8	30.2	25.0
Real GDP growth (percent)	5.8	5.5	3.6	2.9

[a] Estimated.

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The Deepening Decline. Prolonged stalemate with the IMF and mounting damage from Nyerere's social schemes have added to a variety of other factors to spell continuous problems over the past two years. Real GDP growth averaged just over 3 percent in 1980 and 1981—barely enough to keep pace with population gains. At the same time, 25- to 30-percent inflation rates and mounting shortages of basic consumer goods further eroded low living standards. 25X1

Agriculture, especially, has suffered serious and lasting damage. Compounding the years of chaos under *ujamaa*, stringent price controls on food have suppressed output even below the low levels that might

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have been expected in the face of continuing drought. So, too, has smuggling to nearby countries, especially Kenya. Disillusionment with the government's farming schemes prompted some Tanzanian farmers to leave their communal plots and return to traditional villages, further disrupting output of cash crops. Others have fled to urban areas, boosting the urbanization rate to among the highest in Africa. The deterioration of the transport and marketing systems, spurred by equipment and parts shortages and poor management, has intensified the impact on consumers of production shortfalls. [redacted]

As current account and budget deficits have piled up, all aspects of financing have become much more difficult. The high cost of maintaining Tanzania's military presence in Uganda combined with large food and fuel import bills and a 10-percent drop in export volume in 1981 caused the current account deficit to balloon to $750 million. Nyerere had expected substantial Western support for helping to oust the Idi Amin regime, but his appeals drew only small increases from regular donors. By the end of 1981, Tanzania's foreign exchange reserves had been nearly depleted, to less than one week's import cover. [redacted]

Meanwhile, the financing of government expenditures began to absorb even more domestic resources. Even though the share of expenditures allocated to defense came down with the subsidence of the Ugandan war, the government's decision to take the lid off public-sector wages helped to keep the ratio of total public spending—about 29 percent of GDP—from falling. Last year's wage hikes added about $70 million to the government payroll, stirring inflation and budget problems. [redacted]

Bleak Outlook in 1982. The economy will continue to stagnate this year. Real GDP growth is unlikely to match last year's 2.9 percent. Shortages of materials and adverse government policies will offset any benefits from good weather in the agricultural sector. Tanzania's few factories typically are running at 20 to 30 percent of capacity, because of equipment and raw material shortages and recurrent power failures. Moreover, the combination of expansionary financing of budget deficits, wage increases, and insufficient consumer goods already has lifted inflation to an annual rate of 35 percent, and it will almost surely continue to rise throughout this year. [redacted] 25X1

Tighter import controls probably will throttle growth in the current account deficit in 1982 much beyond last year's level. Domestic producer disincentives, in the form of lower-than-market prices to coffee and cotton producers and reduced world prices for Tanzania's major exports, will cause export volume and earnings to fall again this year. As a result, Tanzania will not have enough foreign exchange to import simultaneously the $100 million in needed foodstuffs as well as the raw materials and intermediate goods vital to maintaining production. Because the foreign exchange bind has prevented Tanzania from taking advantage of lower spot prices for oil, domestic fuel consumption stands at only 75 percent of the 1980 level. [redacted]

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Negotiations with the IMF for enough money at least to help pay Tanzania's short-term debts [redacted] remain acrimonious. The Fund's insistence on as much as a 60-percent devaluation of the shilling, the dismantling of some parastatals, and other steep cuts in government spending—especially consumer subsidies—are meeting stubborn resistance. Traditional major donors—including Sweden, the Netherlands, and West Germany—are reported by embassy sources to be increasingly reluctant to bail out the Tanzanian Government without an IMF agreement. Tanzania's severe financial bind and heavy donor pressure prompted Nyerere grudgingly to impose a 10-percent devaluation in March. He has openly stated, however, that IMF prescriptions for Tanzania are counterproductive because they would intensify shortages of imported producer and consumer goods alike, thereby thwarting attempts to raise output for domestic and export sales and to lower inflation. There is little reason to believe that government companies, which absorb about 90 percent of imports, would allocate these purchases to their most productive uses. [redacted]

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IMF demands for substantial cuts in government expenditures, according to embassy sources, rankle Tanzanian officials. As matters stand, Tanzania's 25X1

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budget deficit is slated to exceed $400 million—or 10 percent of GDP—by mid-1982. Even keeping the shortfall at this level seems overly optimistic, however, [redacted] Substantial belt tightening to meet Fund requirements would entail politically risky slashes in government services and an end to bailing out parastatals, which employ one-third of the country's 600,000 wage earners. [redacted]

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Leadership Alternatives and Economic Consequences. Nyerere has often said that he wants to step down as head of state but remain as president of Tanzania's only political party. The longer the economy deteriorates, however, the greater will be the risk of a military takeover. We believe that such a move would result in a regime that repudiated Nyerere's economic policies. We also believe that the military would distance itself from trying to solve the country's economic problems, preferring, instead, to give that job to the Western-educated technocrats now manning most government ministries. [redacted]

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Even if a new regime were to implement a more rational development plan, it would take some time, perhaps five years, to revitalize Tanzania's economy. Considering the low levels of investment in the last several years, it would be difficult to elicit the kinds of positive responses from producers that might be expected from a substantial devaluation. Even a sustained commitment to restructuring key institutions and improving the country's infrastructure would require time and would keep the Tanzanian economy highly aid dependent. [redacted]

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Some accommodation with the IMF will be critical to any progress to be made over the next several years. Aside from badly needed financial guidance, an IMF agreement would facilitate continued Western assistance and some commercial bank financing. This support, however, would have to exceed debt repayment requirements for Tanzania to stick to vigorous IMF stipulations. Otherwise, Tanzania probably would fall further behind on its short-term obligations and would begin to lag in servicing its $1.3 billion medium- and long-term debt. [redacted]

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Conflict With the IMF

August 1975 — *Twin effect of oil price increases and world recession precipitates balance-of-payments crisis that forces Tanzania to take down $12.3 million IMF standby credit. Nyerere government implements 10-percent currency devaluation, restricts imports and wage increases, raises food prices, and redirects public development spending toward productive sectors.* [redacted]

October 1979 — *IMF refuses Tanzania's request for $250 million standby agreement. Nyerere rejects Fund conditions, including a $62 million cut in government spending, a 25-percent devaluation, higher domestic interest rates, and removal of price and import controls.* [redacted]

September 1980 — *Two-year IMF program worth $255 million put in place. Includes $235 million in standby credits and $20 million in compensatory financing.* [redacted]

December 1980 — *Standby credits canceled after only $33 million drawn because Dar es Salaam failed to meet ceilings on import arrears, public spending, and domestic credit expansion.* [redacted]

May 1982 — *Negotiations to reinstitute an IMF program, deadlocked since January 1981, may resume. Tanzanian Government appears desperate for an agreement and is reportedly ready to make substantial cuts, about $160 million, in the government budget. Nyerere's continued obstinance, however, may prove an obstacle.* [redacted]

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Table 3 Million US $

Tanzania: Foreign Economic Aid and Debt

	1978	1979	1980
Total aid disbursements, net	**516.3**	**744.4**	**838.4**
Bilateral	402.2	591.5	681.9
United Kingdom	33.6	59.9	141.5
Netherlands	63.4	94.4	88.7
Sweden	64.2	105.2	87.2
West Germany	63.3	87.3	81.3
Norway	30.7	38.7	52.2
Denmark	38.1	50.1	37.1
Japan	23.0	28.6	33.2
Italy	−5.8	27.3	32.1
United States	14.0	22.0	28.0
Other	77.7	78.0	100.6
Multilateral	114.1	152.1	156.5
External debt [a]	**1,159.7**	**1,218.4**	**1,300.0**
Official	1,051.2	1,098.7	1,150.0
Private	108.5	119.7	150.0
Debt service	54.9	58.0	108.0
Official	27.2	34.7	56.4
Principal	10.4	12.6	29.5
Interest	16.8	22.1	26.9
Private	27.7	23.3	51.6
Principal	20.2	14.7	35.1
Interest	7.5	8.6	16.5

[a] Public and publicly guaranteed medium- and long-term debt.

Dar es Salaam has few external financing alternatives, however. Previous attempts to garner backing from the Soviet Bloc have yielded little. We believe that Libyan support for Amin in the Ugandan conflict makes it unlikely that Dar es Salaam will consider turning to Tripoli for help.

Uganda: Fragile Recovery [4]

President Obote's government, in office since December 1980, has had some success in pointing Uganda toward recovery after eight chaotic years under Idi Amin. A package of reforms announced in June 1981 has reduced the government's involvement in the economy and provided a ray of hope for farmers and the few remaining businessmen. All-important coffee production is recovering and there are some signs of reduced requirements for food aid. Still, continuing problems in domestic security and the risk of renewed tribal infighting could lead to Obote's overthrow and upset the fragile recovery at any point.

The economic cost of Amin's reign was a sharp decline in per capita income for eight years and the total disruption of the private sector. From one of the most promising African economies in the 1960s and early 1970s, Uganda plummeted to one of the poorest in the world. By the mid-1970s Uganda was one of the approximately 20 least developed countries designated by the United Nations. A sharp drop in world coffee prices after 1977, combined with the progressive decline in other productive sectors, deepened the long slide.

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The current government came to power in December 1980 as a result of the Tanzanian invasion of Uganda. By June of 1981 the IMF had convinced President Obote that he should take a variety of measures to rationalize domestic prices and the exchange rate, thereby encouraging the private sector. Accordingly, Obote removed price controls on consumer goods, increased producer prices for coffee and food, and allowed the shilling to float. Higher producer prices and improved security conditions gave a solid boost to exports, which were further reinforced as the shilling was allowed to float from 7.8 to 86 shillings per dollar. Last year, for the first time since 1973, Uganda was able to meet its international coffee quota of 120,000 metric tons; this year's quota was raised to 174,000 metric tons. The IMF projects that this—and a substantial recovery in food production—will support a real growth rate approaching 6 percent this year, up from 1 percent in 1981.

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There are substantial signs that the 1981-82 recovery can be extended if domestic political and security conditions do not deteriorate. Since announcing the reform package, Uganda has received large-scale commitments of economic assistance. Approximately a third of a total $750 million in promised aid is in the

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Table 4

Milion US $

Uganda: Economic and Trade Indicators

	1978	1979	1980 [a]	1981 [a]	1982 [b]
Trade balance	−8	−31	−75	−20	−180
Exports, f.o.b.	322	326	345	355	535
Coffee	315	319	340	350	525
Imports, c.i.f.	330	357	420	375	715
Net services and private transfers	−167	−146	−214	−145	−150 to −200
Current account balance	**−175**	**−177**	**−289**	**−165**	**−330 to −380**
GDP real growth (percent)	0	−2	0	1	5 to 6
Inflation rate (percent)	80	85	80	100	50 to 100

[a] Estimated.
[b] IMF projections.

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form of balance-of-payments support from the IMF and the World Bank and the remaining two-thirds is project-related assistance from Western donors. In addition, some $70 million of loans to previous Ugandan governments has been canceled by the creditors, and other debts have been rescheduled. While the rate of use of the assistance will depend heavily on sensible project formulations by the Ugandan Government and Western donors, there is a clear historical basis for expansion of tea and copper production, which all but disappeared during the Amin years.

Day-to-day economic management in Uganda is still not easy, however. Though inflation is subsiding somewhat, it is well above an annual rate of 100 percent. Balance-of-payments pressures remain acute—the deficit will be close to $400 million this year—even as shortages of raw materials, spare parts, and consumer goods continue to recur. Urban wage earners have a difficult time buying food at current prices. Security conditions in Kampala and other parts of Uganda are bad, and this disrupts the flow of supplies from the country's most advanced regions.

The success of Obote's efforts to encourage Asian entrepreneurs to return to Uganda, after their wholesale expulsion during the Amin years, will probably be limited. The critical need for skills and investment capital has prompted the government to propose legislation that would facilitate the return of some commercial properties to Asian businessmen or, at least, set compensation for those assets taken over by the government. We believe, however, that the Asians will not return in significant numbers. They remember the anti-Asian sentiment of many Ugandans and are aware that any substantial reinvolvement by Asians in the Ugandan economy would engender substantial political backlash. 25X1 25X1

The key to continued progress in Uganda is a stable political situation. After some earlier fumbling, Obote appears to have gained confidence and greater skill in dealing with the various factions. Nonetheless, serious tribal divisions still plague the country and manifest themselves in dissension in the Army, guerrilla activity, and intragovernment feuding.[5] These frictions have the potential for renewed domestic strife that could topple Obote. Were Obote to come under pressure that he felt could not be relieved solely through Western aid, we believe he would revive his 25X1

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once close ties to Moscow or to seek aid from Cuba or radical Arab states. In our view, most plausible successors would show the same inclination. In any event, renewed turmoil in Uganda, should it come, would have the potential once again to disrupt Uganda's economy as well as those of other East African states. [redacted]

Table 5 Million US $

Somalia: Official International Aid

	1976	1977	1978	1979	1980
Economic assistance	**150**	**285**	**220**	**235**	**510**
Non-Communist	115	260	210	230	495
US	5	5	15	20	60
Other OECD	20	25	45	50	140
OPEC	35	180	100	95	130
International agencies	55	50	50	65	165
Communist	35	25	10	5	15
USSR	15	10	0	0	0
China	20	15	10	5	15
Military assistance	**90**	**575**	**270**	**130**	**100**
Non-Communist	NEGL	520	265	130	80
OPEC	0	460	100	75	80
Other	NEGL	60	165	55	0
Communist	90	55	5	NEGL	20
USSR	90	50	0	0	0
China	0	0	5	0	20
Eastern Europe	0	5	0	NEGL	0

[redacted]

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Somalia: The Economy Continues To Falter [6]

Somalia's economy has stagnated over the past three years as a result of damaging weather, an enormous influx of refugees, high oil prices, and record inflation. As a result, the economy is now dependent on massive amounts of Western assistance to keep afloat. The sudden infusion of these funds, however, has added to already widespread corruption and economic mismanagement. Rising domestic criticism of President Siad's economic policies is contributing to the most serious challenge to his authority since he came to power in 1969. Siad is trying to placate his critics with promises that the agreement permitting US access to Somali facilities has opened the door to funds needed to revive the economy and restore Mogadishu's military. [redacted]

Siad's Takeover and Ensuing Economic Decline. Somalia has few natural resources on which to base economic development. Much of the country is semiarid and two-thirds of the population is nomadic. The small commercial agricultural sector is primarily centered around livestock and banana production. Western oil companies are doing some exploratory work along the coastline, but industry officials remain pessimistic about finding commercially significant oil deposits. [redacted]

Siad did nothing to enhance Somalia's development prospects when he decided to impose socialism shortly after assuming power in 1969. He established a number of government-owned corporations and staffed them with inexperienced political cronies who viewed their jobs primarily as a means to enrich themselves. At the same time, the government instituted price controls to limit the cost of living in politically sensitive urban areas. The combination of poor management and inadequate price incentives soon resulted in economic stagnation. Recurrent drought and the unsuccessful invasion of the Ogaden hastened the decline of Somalia's economy. Import costs took a leap in 1980 with the loss of concessionary oil supplies from Iraq, Somalia's sole supplier. [redacted]

Mogadishu initially tried to cope by permitting massive budget and current account deficits, which in turn fueled inflation and by the end of 1980 nearly exhausted the country's meager foreign exchange reserves. Siad tried to hold down inflation by banning price increases, but merchants responded by withholding goods or shifting them to the flourishing black market. Corruption became more pervasive among government civilian and military personnel—many of whom had not had a pay increase in nearly 10 years.

[redacted]

[redacted]

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Table 6 Million US $

Somalia: Selected Economic and Financial Indicators

	1979	1980	1981 [a]	1982 [b]
Trade balance	−393	−511	−350	−305
Exports, f.o.b.	106	137	172	185
Imports, c.i.f.	499	648	522	490 [c]
Military purchases	95	185	47	NA
Net services and private transfers	14	49	34	75
Current account	**−379**	**−462**	**−316**	**−230**
Foreign exchange reserves	54	25	42	70
External debt	571	685	750	NA
Ratio (percent)	4	5	14	NA
Inflation rate (percent)	17	70	45	40
Real GDP growth (percent)	−3	0	1	1

[a] Estimated.
[b] Projected.
[c] Excludes military purchases.

[redacted]

The Search for Aid. Growing popular unrest over the deteriorating economy finally persuaded Mogadishu to seek help. The International Monetary Fund in 1980 provided a $50 million stabilization program in exchange for an agreement by the Somalis to rein in public spending, devalue the currency, increase agricultural prices, and eliminate some of the more inefficient parastatal organizations in favor of private enterprise. [redacted]

In addition to the IMF loans, Mogadishu acquired funds from several other sources. Almost all of the cost of refugee relief is now covered by contributions from Western governments and international agencies. Somalia has also used its membership in the Arab League to obtain from various OPEC institutions sizable sums, a large part of which is used to purchase military equipment. [redacted]

The economy continued to flounder last year despite some progress in implementing the IMF conditions. [redacted] farmers were pleased with the decision to raise producer prices, but the move came too late to have much impact on plantings. In addition, output was affected by heavy rains and flooding last September. Mogadishu did have limited success in moderating budgetary spending, which helped ease inflationary pressure. Nevertheless, consumer prices were still up by 45 percent. Efforts to generate additional revenues through a 25-percent tax on livestock stopped all shipments last fall. Deliveries resumed later in the year only after Mogadishu agreed to a substantial reduction in the tax rate. [redacted]

Siad Looks to the United States. Siad is counting on the United States to become his principal benefactor. According to both embassy and Somali sources, since breaking ties with the Soviets in 1977, Mogadishu's military establishment has deteriorated substantially. He believes that his agreement to permit US military forces access to Somali facilities entitles him to money needed to reequip his army and pay for food and other basic consumer imports. [redacted]

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Additional US economic aid may be needed to offset possible losses of other overseas assistance. Money for refugee relief is likely to decline in view of a recent UN census that indicates the number of refugees is considerably lower than the Somalis claim. In addition, if Arab-US relations deteriorate, some Arab donors could use Siad's close association with Washington as a pretext for a cutoff or slowdown of aid. Several Arab donors have also been distressed by the occasional diversion of foreign aid into the private bank accounts of Somali officials. 25X1

Even with ample foreign aid, Siad has little chance of revitalizing the economy during the next year or so. At a minimum, he will have to turn over more of the settled economy to private hands to generate improvements in productivity. To do so, however, risks offending important political forces that have gained financially from the present system. Even if Siad scraps his socialist policies, Somalia's economic well-being will still depend largely on the performance of the agricultural sector, which, in turn, will fluctuate with weather patterns. 25X1